Abstract

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Why do people become part-time entrepreneurs? Are they credit constrained? Previous studies on entrepreneurship do not deal with part-timers, that is, workers who devote some of their time to self employment and some of their time to working for wages. In contrast, a recent survey on the establishment of new businesses reports that 80 percent of nascent entrepreneurs also hold regular wage jobs. I develop a model of entrepreneurial choice in which individuals decide not only how much capital to invest, but also what proportion of time to spend in business. The model allows me to test whether entrepreneurs are credit constrained. I use a new and unique data set, which looks at how nascent entrepreneurs divide their time between their own businesses and other jobs. My empirical findings show that part-time entrepreneurs do not appear to be constrained. This is not to say that no entrepreneur is credit constrained. It might be that a lot of part-time business owners operate in less capital intensive sectors. Instead, the result points to the marginal entrepreneur. If credit constraints are crucial, wealthier entrepreneurs should shift their time a lot more into their businesses, because the credit constraints would have been relaxed.

Extended Abstract

New businesses often rely on individual and household wealth as a source of start-up capital, financial security, or insurance for acquiring funds (Gartner et al. 2004). This seems to suggest that assets have a crucial effect on the level of entrepreneurial activity. In their seminal studies, Evans and Jovanovic (1989), Dunn and Holtz-Eakin (1994), and Holtz-Eakin et. al. (1994) find empirical evidence that entrepreneurs are credit constrained, and that wealthy people, who are better able to obtain substantial amounts of initial capital, are more likely to be involved in entrepreneurial activities. Hurst and Lusardi (2004), however, show that wealth effects are significant only for the top 5 percent of the wealth distribution. In this paper, I examine the effect of initial wealth on the tendency to participate in a business start-up for part-time entrepreneurs and argue that wealth does not significantly affect the propensity to become an entrepreneur.

Part-time entrepreneurs are people who work a regular wage job some of the time and work at their own businesses the other part of the time. Why are there these part-time entrepreneurs? Why don't they just devote all their time to their own businesses? One hypothesis for the existence of part-time entrepreneurship is that people are credit constrained. They would like to borrow enough to build their businesses and put food on the table during the early years when the enterprise is still small and not yet generating very much cash. If they cannot borrow, the only way they can get money to pay their bills is to work at a regular job.

Early studies on entrepreneurship do not deal with part-timers. Instead, they use self-employment as a proxy for entrepreneurship and focus on the selection into self-employment and the effect of different factors on it. These studies employ data from labor market surveys that treat respondents as either self-employed or wage workers and that do not allow the two groups to overlap. Do we have to worry about part-time entrepreneurs? Recent evidence from a large crossnational study on the level of entrepreneurial activity (Global Entrepreneurship Monitor, 2003 Executive Report) has established that 80 percent of those who implement start-ups also hold regular wage jobs. These findings conflict with the theories of entrepreneurial choice in which individuals choose only between outside paid jobs and self-employment, and in which the complexity of entrepreneurial activity is not reflected.

In this study, I develop a model of entrepreneurial choice in which individuals decide how much capital to invest and what proportion of time to spend in business. To examine the importance of credit constraints, I estimate a reduced-form probit model. The probability of starting a new business and wealth would be positively correlated if and only if there are credit constraints. Wealth, however, is likely to be endogenous: what helps people become wealthy might be the same quality responsible for their unobservable entrepreneurial talent. To deal with wealth endogeneity, I propose a new method for instrumenting wealth. I use month-to-month changes in the Standard & Poor 500 stock market index that serve as a source of assets variation exogenous to entrepreneurial decisions.

I test the wealth hypothesis using data from the Panel Study of Entrepreneurial Dynamics. The PSED is an extensive nationally representative survey of the establishment of new businesses reporting that 50 percent of nascent entrepreneurs have full-time work and 20 percent have part-time wage and salary work outside the start-ups. This new and unique data set provides detailed information on how nascent entrepreneurs divide their time between their own businesses and other jobs.

My empirical findings show that part-time entrepreneurs do not appear to be constrained. In my regressions, where on the left-hand side is an indicator of either being an entrepreneur or being a wage worker and on the right-hand site (along with other controls) is wealth, the wealth variable is not significantly different from zero. This is not to say that no entrepreneur is credit constrained. Instead, the result points to the effect of wealth on the marginal entrepreneur. The intuition is based upon the role of wealth. If credit constraints are crucial, wealthier entrepreneurs should shift their time a lot more into their businesses, because the credit constraints would have been relaxed.